

Prof. Hall is, in essence, saying that he can ignore market outcomes because he cannot understand the source of the efficiencies. If consumers have demonstrated they prefer one-stop shopping, they must be wrong accordingly to Prof. Hall.

26. Prof. Hall attempts to explain SNET's success in Connecticut with 35-40% of the long distance market by claiming that "SNET has a huge competitive advantage". (p. 28) He admits that SNET's prices are lower in Connecticut: "The national long-distance carriers would have to lower their prices nationally in order to respond to SNET's pricing".⁹ Contrary to Prof. Hall, SNET's entry has led to lower prices for consumers. Prof. Hall's assertion is incorrect because he fails to consider SNET's one rate type plan when he considers analogous plans from AT&T and MCI. SNET's prices are lower by about 17% as I demonstrated in my first declaration and thus customers have benefitted from SNET's supposedly "huge competitive advantage". Firms compete based on competitive advantages and customers benefit when the advantages are used to lower prices.

27. Prof. Hall agrees that the margin inherent in long distance access can lead to the result that "the local carrier may reduce the price of long-distance service".¹⁰ (p. 30) But he states that this effect should not be considered as a benefit! Lower prices always benefit consumers (holding

9. Note that this admission directly contradicts Prof. Hall's later assertion that AT&T offers lower long distance prices nationally than SNET does in Connecticut. (see Hall, p. 66)

10. Note that statement directly contradicts Prof. Hall's subsequent claim that double marginalization will not lead to lower long distance prices. (p. 64)

quality constant). Again Prof. Hall wants to deny benefits to consumers because he does not like how they arise, here through vertical integration. Furthermore, since he has no answer to consumers voting with their dollars to buy SNET's long distance service, he states that this large market share is "no indicator of social benefits". Here he is directly contradicted by economic theory which demonstrates that consumer benefits are directly proportional to the revenue from a "new brand" as I have demonstrated in my academic research.¹¹ Prof. Hall attempts to deny well accepted economic theory in his attempt to claim that BOC entry into long distance will not create consumer benefits.

28. Prof. Hall claims that the long distance market is competitive by considering the real price of long distance in his Figure 1 (p. 41). Here he has combined business and residential calls, so that the main effect of BOC entry, lower prices for residential customers, would not appear. Businesses may have a competitive long distance market; residential customers do not. Furthermore, as demonstrated by Prof. Hall's Figure 2, both the real CPI for long distance and real PPI for long distance services have been essentially constant since 1991 (Prof. Hall does not provide the data so no exact calculations can be done). Prof. Hubbard and Lehr provide a more accurate compilation of long distance prices over the 1990-1995 period which shows that no decrease in residential nominal long distance prices exists. When Prof.

11. See J. Hausman, "Valuation of New Goods Under Perfect and Imperfect Competition", in T. Bresnahan and R. Gordon, The Economics of New Goods, Univ. Of Chicago Press, 1997; "Valuation and the Effect of Regulation on New Services in Telecommunications", forthcoming in Brookings Papers on Economic Activity: Microeconomics, 1997; and "The CPI Commission and New Goods", American Economic Review, 1997.

Hall compares access charges to long distance revenues (p. 45), he again mixes business and residential revenues. Using data from Prof. Hubbard and Lehr, I demonstrated above that residential long distance prices have increased over the 1990-1995 net of access charges. Thus, Prof. Hall's use of combined business and residential data does nothing to demonstrate that residential long distance customers receive competitive prices.

29. Alone among all the economists in this proceeding, Prof. Hall disagrees with my double marginalization analysis. (pp. 64-65) Prof. Hall misunderstands the argument--it is not that the downstream operation faces the upstream marginal cost since an opportunity cost exists of selling long distance access to the IXC's. However, when the profit maximization calculations are carried out (as they are done in many textbooks), the vertically integrated company has an economic incentive to lower price because it will gain additional profits from its own and its competitors' use of increased long distance access.¹² The IXC's do not have this extra economic incentive.

30. Prof. Hall disagrees with my comparisons of SNET's prices to AT&T's prices and he comes to the remarkable and incorrect conclusion that SNET is not cheaper than AT&T (p. 66). Prof. Hall's conclusion is remarkable because he has no explanation for why SNET has a 35-40% market share in long distance and is growing at 40% per year. (Hausman, para. 16) Have this many consumers

12. Prof. Hall claims that this incentive arises from above cost access prices. He is wrong. So long as access prices reflect the significant sunk costs of providing long distance access, the economic incentive remains for a LEC to offer lower long distance prices.

made the wrong choice? Prof. Hall is also incorrect because his comparison standard is a 10 cent rate from AT&T. Here Prof. Hall is wrong for two reasons: (1) he fails to state that the AT&T 10 cent plan requires a monthly payment of \$4.95 per month. Thus, compared to the much more widely advertised AT&T plan of 15 cents per minute, which requires no monthly charge, a user would need to make 100 minutes of calls per month until he broke even.¹³ For many users near this amount, they would need to make significantly greater use of the plan to compensate for months where they made fewer calls and fell below the break even limit. (2) Many AT&T customers make use of no plan. Indeed, the most recent data reported in the business press indicates that only about 1/2 of AT&T's customer use any type of discount plan.¹⁴ These customers would all benefit by going to SNET, no matter what their level of calling, as I demonstrated in my first declaration.

31. Furthermore, SNET bills by the second and AT&T generally bills by the minute. When these features are accounted for as I discussed in my first declaration, a user would need to make over 150 minutes of long distance calls before breaking even on the AT&T plan. Indeed, it is remarkable that Prof. Hall's client MCI does not offer a competitive offering to the AT&T plan that Prof. Hall discusses, since MCI's least expensive one rate plan is 12 cents a minute for amounts beyond \$15 per month.¹⁵ If the AT&T plan were widely known

13. Prof. Hall gives no source for his claim that the 10 cent rate is "widely advertised". The AT&T 15 cent rates is much more widely advertised, at least in my experience.

14. "AT&T Will Simplify Its Pricing Structure", New York Times, Nov. 5, 1997, p. D6.

15. The MCI plan is 15 cents per minute otherwise.

and used as Prof. Hall implies, I find it extremely unlikely that MCI would not respond with a similar plan, but would only offer a higher priced plan. MCI's brand name is not so powerful that it could charge a higher price than AT&T. The economic facts of SNET's market gains and MCI's own pricing behavior are grossly inconsistent with Prof. Hall's claims. Thus, the 17% lower prices which I calculate in my first affidavit is not affected by the discount plan citations of Profs. Hubbard and Lehr, Hall, and Schwartz. Economic analysis of prices cannot be based on the "best plans", it must be based on plans chosen by actual consumers in the marketplace. My calculations which consider all AT&T plans across choices actually made by residential consumers leads to the 17% difference between SNET and AT&T.

32. Prof. Hall also errs in his criticism of my comparison to Canada. He again gets the facts wrong in claiming that the AT&T 10 cent plan is cheaper than Canada because he fails to note the \$4.95 monthly payment. Compared to Sprint in Canada a user would need to make 618 minutes of calls per month to break even using the AT&T plan, which is well beyond all but the largest users of long distance. Compared to Telus' long distance plan in Canada, a break even point might not even exist depending on the split between peak and offpeak calls. For an offpeak caller, Telus is always cheaper. Prof. Hall also states that the Canadian comparison should be done in terms of purchasing power parity.¹⁶ However, even doing a modification using purchasing power parity calculations done by Statistics Canada (the Canadian statistical agency), Sprint's Canadian price would still only be 12.9 cents

16. I do not agree with this criticism since, as I explained in my first declaration, long distance access prices are higher in Canada (in terms of US dollars) and equipment prices are determined in international markets.

per minute (with no monthly fee) for any time of day which is below prices offered by AT&T, Sprint, and MCI in the U.S., except for large users. Thus, Canadian prices continue to be below U.S. prices, even after adjustments.

V. Prof. Schwartz (DOJ)

33. I reply to the Supplemental Affidavit (Nov. 3, 1997) by Prof. Marius Schwartz, filed on behalf of the DOJ. I find it quite important that Prof. Schwartz has not changed his position at all despite the recent ruling by the Eighth Circuit. In terms of cost and benefits which can be forced by regulatory intervention by the FCC (endorsed by the DOJ) rather than allowing competition to occur, Prof. Schwartz position is identical to his earlier affidavit. ("Competitive implications of Bell Operating Company Entry Into Long-distance Telecommunications Services", May 1997). He admits to not quantifying the benefits or costs of delaying BOC entry (p. 4), but he comes to the same conclusion as before. When the institutional framework changes (here, by ruling out DOJ's prior view of the 1996 Act), economic conclusions change in what is known as "comparative statics" in economic analysis.¹⁷ But since Prof. Schwartz has no model in which to assess his conclusions, contrary to myself and other BOC economists, he cannot analyze how institutional changes affect his conclusions. I find it to be a strange economic model indeed, which demonstrates no changes in conclusions to a major change in the

17. Indeed, Prof. Paul Samuelson demonstrated the importance of this approach in this Foundations of Economic Analysis, Cambridge, 1948. Prof. Samuelson won the Nobel prize in part for this book.

institutional structure.¹⁸

34. Prof. Schwartz's reiterates that his conclusions rest on two main points: (1) the local market is larger than the long distance market and (2) the long distance market is more competitive. However, economic conclusions cannot be based on these two pieces of data alone without economic analysis. I repeat my fundamental equation from my first declaration which no economist in this proceeding, including Prof. Schwartz, has criticized.

Change in Consumer Welfare from Price Changes

$$\begin{aligned}\Delta W &= \sum_{i=1}^n -\Delta p_i (q_i + .5\Delta q_i) \\ &= \sum_{i=1}^n -\frac{\Delta p_i}{p_i} [p_i q_i + .5\eta_i \left(\frac{\Delta p_i}{p_i} \right) (p_i q_i)]\end{aligned}$$

where: q_i = quantity (1)

p_i = price

η_i = price elasticity

$\Delta p_i / p_i$ = percentage change in price

As the equation demonstrates, the two most important changes in consumer welfare arise from the change in price and from the price elasticity.¹⁹ Yet,

18. Indeed, it becomes difficult to separate ideology from economics when a conclusion does not change in response to a major change in the institutional framework.

19. Indeed, Prof. Schwartz makes a rather elementary economic error by not analyzing the relevant economic factors. He states that "The same percentage improvement in economic performance in both markets in response to

Prof. Schwartz has nothing to say about these parameters in markets for local services or for long distance services. I described in my first affidavit that price changes are likely to be larger in long distance because of effective regulation of local services and that the long distance elasticity is many times larger, indeed more than 100 times larger, than the local access elasticity. Since Prof. Schwartz does no formal economic analysis, he cannot conclude that benefits to delayed long distance are outweighed by his perceived benefits of faster local competition. Indeed, I believe that he is incorrect for reasons I discussed in my first declaration. Prof. Schwartz uses the phrase "the above logic" (p. 5), but he not done the requisite economic analysis.

35. Prof. Schwartz (p. 9, para. 21) asks a rhetorical question about improvement from competition in BOC markets "that today are largely monopolies". He forgets to say in this paragraph that the BOCs are regulated monopolies. Thus, no monopoly profits are being earned if the regulators are doing their job. The price distortions that exist come about largely due to regulation. Rural consumer receive quite large subsidies for local telephone service. However, the BOCs do not create this policy by exerting monopoly power. The FCC and state regulators cause this outcome. For the FCC and DOJ to refuse to permit BOC entry because of the distortions created in part by the FCC itself is to doubly harm consumers: the harm created by cross

increased competition would there generate considerably greater total benefits in the local market." (p. 8) Prof. Schwartz would only be correct if the demand elasticities were the same in both markets. They are not since the long distance elasticity is over 100 times greater than the local access elasticity. Prof. Schwartz's mistake demonstrates the mistakes that can be made when no formal economic analysis is done.

subsidies and taxes imposed by the FCC and the harm created by supra-competitive long distance prices.

36. Prof. Schwartz (pp. 17-18, fn. 16) agrees with my claim that a marginal analysis is the correct way to proceed. However, he disagrees that the remaining barriers can be accurately portrayed as minor. But Prof. Schwartz has no way of deciding whether remaining barriers are "major" or are "minor" since he has no model to do the analysis and quantify the effect of remaining barriers. With no available model, Prof. Schwartz cannot draw reliable conclusion, nor are his conclusions falsifiable.²⁰ It has been known since the 1930's that if conclusions are not falsifiable, then they do not provide a scientific guide to decision making.²¹

37. Prof. Schwartz makes another economic error when he criticizes my "double marginalization" analysis. He states that the imputation requirement of Section 272 of the Act will cause a BOC to charge itself an access charge no lower than what is charged to an IXC. (p. 25) Where Prof. Schwartz goes wrong is that he fails to understand that employees will see beyond the "corporate veil" and take into account, at least to an extent, both margins that exist under imperfect competition. Otherwise, whenever a corporation had separate division and the upstream division charged the downstream division a transfer price, the company would make the incorrect pricing decision.

20. By falsifiable I mean that without quantification, it is impossible to decide whether barriers are "minor" or "major".

21. Indeed, Prof. Schwartz's rather lengthy discussion on shifting of presumptions on pp. 20-21 demonstrates the opinion basis rather than a scientific basis for his affidavit. Arguments on shifting of presumptions are "lawyer talk" and do not reflect any actual economic analysis.

38. Since Prof. Schwartz cannot refute the double marginalization theory, he turns to the possibility of access discrimination. Here he makes yet another mistake. "Raising rivals costs" is a hypothetical possibility, but economic analysis demonstrates that the gains from vertical integration exceed the gains that could be realized by raising rivals costs in the current situation (and most other situations), even if regulation were not effective. Prof. Schwartz misses the point that merely making an argument (e.g. the possibility of discrimination) does not substitute for economic analysis. Furthermore, he never addresses the point, which I discussed in my first declaration, of why every other country has allowed vertical integration into long distance. Does Prof. Schwartz believe that the possibility of raising rivals costs does not exist in Canada? Yet the Canadians allow LECs to provide long distance and have lower long distance prices as I discussed in my first declaration. This empirical evidence would seem to cast a large element of doubt on Prof. Schwartz claims.²²

39. Prof. Schwartz makes a rather fundamental mistake (pp. 26-27) when he uses the industry elasticity of demand for long-distance (he uses 0.7) to conclude that the BOCs would prefer to raise the interLATA price, not lower it as I claimed and as experience in Connecticut with SNET has demonstrated. His

22. Prof. Schwartz also never considers the experience in the U.K. residential market where about 7% of customers now subscribe to non-LEC (BT) service (ITC Cable Statistics, <http://www.cable.co.uk>) and BT now has negative growth in its residential lines service. The U.K. (OFTEL) has not followed the "regulatory perfection" standard of the U.S. but yet has much more local competition. Indeed, the U.K. has no forced unbundling and no forced TELRIC pricing yet residential consumers have a much large choice. Thus, Prof. Schwartz recommendation of continued regulation with absolute barriers to BOC interLATA entry is flatly contradicted by the actual market outcomes in the U.K.

mistake is that a BOC would face a firm elasticity of demand, not the industry elasticity of demand. The firm elasticity of demand is higher than the industry elasticity of demand and will exceed 1.0 in magnitude. The correct economic model then demonstrates that the BOC will desire lower prices unless it is able to achieve an extremely large share of the market, well beyond any realistic expectations. Prof Schwartz is only correct if he assumes (at least implicitly) that the BOCs will engage in coordinated interaction or form a cartel with the incumbent IXC's. Such an outcome seems extremely unlikely given the BOCs' economic incentives and the experience of SNET to date.

40. Prof. Schwartz goes on to claim that the profit from BOC entry into long distance would come largely from diverting sales from IXC's. (p. 27) I never claimed otherwise, but since economics takes place at the margin the increased long distance usage from the lower price (which Prof. Schwartz agrees is likely to happen) will be a factor in increased consumer welfare (see my equation (1)).²³ To attempt to refute my analysis Prof. Schwartz compares his forecast of BOC retail revenues from long distance with the added profits from increased access minutes. This revenue/profit comparison is classic apples and oranges. In fact, Prof. Schwartz's necessary assumption that BOCs will have high long distance profits further contradicts the claim made by Prof. Schwartz that he believes that long distance is considerably

23. Indeed, in para. 20 of my first declaration I calculate that the consumer welfare increase from the lower prices due to increased usage is about \$400 million year which is much smaller than the consumer welfare effect (\$6.2 billion) effect based on the same amount of usage. These calculations demonstrate that the main effect on consumer welfare is from lower price competition from the BOCs to the IXC's for the current amount of traffic.

more competitive than local service.²⁴ However I have a much more fundamental objection to Prof. Schwartz conclusion here: he is protecting the profits of IXCs rather than analyzing the effects on consumers. Indeed, his analysis in this section is entitled "diverting sales from IXCs". (p. 27 and p. 29) No DOJ economist should worry about the fate of the incumbent IXCs here; the relevant question is the lower prices and increased consumer welfare. Somehow the process of competition has become subverted to protecting the current IXCs market share and profits. Prof. Schwartz does not consider how the BOCs will be able to "divert output away from IXCs" (p. 29) except by offering consumers a better deal. Don't consumers matter in the DOJ calculations?

41. Prof. Schwartz misstates my position (p. 31): he states that I "assume" that BOC entry would bring about a price reduction of about 18%. He fails to understand that my economic analysis and quantification led me to this conclusion. My approach is very much different than Prof. Schwartz; I look at actual market data rather than making unsupported arguments. He goes on to state that I overestimated the benefits from BOC entry since "only 77% of interLATA minutes originated in BOC service areas". (p. 31) Prof. Schwartz fails to note that all of the large IXCs have uniform national pricing policies, partly as a result of regulation and partly as a result of the inherent complications in billing systems. If AT&T is subjected to greater competition for 77% of its traffic, I will safely predict that AT&T will lower

24. Prof. Schwartz does not explain why he uses such high margins for long distance if he believe his earlier claim that long distance is significantly more competitive than local service.

its prices on a nationwide basis.²⁵

42. Prof. Schwartz criticizes my focus on certain AT&T rate plans. He is incorrect since I consider all AT&T rate plans. However, Prof. Schwartz gives no answer to my previous statements that AT&T spokespeople have stated that about 50% of AT&T customers do not have a discount plan which continues to be true today.²⁶ Prof. Schwartz engages in the same selective claims as the IXC economists by demonstrating that for some customers, IXCs offer lower rates for certain usage patterns. But he fails to answer the \$64,000 question: why does SNET have a 35-40% market share if customers do not find that they are getting a better deal?²⁷ Prof. Schwartz lastly states that BOC entry could "accelerate" price decreases, but that over time the effect of the competition by BOCs would be less. (pp. 34-35) Unfortunately, Prof. Schwartz has forgotten the most famous dictum in economics: In the long run we are all dead. Current FCC policy is costing each household on average about \$60-\$70 per year in supra-competitive long distance charges. This ongoing consumer harm must be considered in any public interest determination against

25. Prof. Schwartz says that high volume customers will see less of a price decrease. (pp. 31-32). I agree; see the analysis in para. 16 of my first declaration. I have averaged price differences across difference usage patterns. However, Prof. Schwartz makes a mistake when he compares SNET's 12 cent rate to AT&T's rates. SNET charges on a per second increment basis while AT&T charges on a per minute increment basis. The difference is significant as I explained in para. 19 of my first affidavit.

26. "AT&T Will Simplify Its Pricing Structure", New York Times, Nov. 5, 1997, p. D6.

27. Prof. Schwartz admits that "some SNET customers may well be enjoying better rates." (p. 33) I submit that as a matter of economic analysis which should respect consumer sovereignty that almost all SNET customers are getting what they consider a better deal or they would not choose SNET. AT&T and MCI are hardly unknown companies to almost all long distance consumers.

uncertain claims about what might happen in the long run.

VI. DOJ Lawyers

43. I reply to the portion of the legal brief filed by the DOJ (December 10, 1997) in which the DOJ attempts to defend Prof. Schwartz with respect to Prof. Schwartz's failure to take account of the Eighth Circuit's decision (DOJ, p. A2). The DOJ lawyers fail to recognize that, as explained in my first affidavit, correct economic decisions are made on the margin. Indeed, Prof. Schwartz agreed with this point (Schwartz Reply, pps. 17-18, fn. 16). When conditions change such as the Eighth Circuit decision, the marginal calculation also changes. Yet Prof. Schwartz has no way to analyze the required change since he has no economic model. Needless to say, the DOJ lawyers put forward no economic model to contradict the basic model I have used throughout this proceeding, which is again set forth as equation (1) above. The DOJ lawyers attempt to substitute rhetoric for economic analysis.

44. I criticized Prof. Schwartz for his mistake in not taking into account demand elasticities when considering the effects of competition. The DOJ lawyers now agree that the elasticity for the basic local exchange rate is near zero, so that price decreases in long distance prices have orders of magnitude larger effects on consumer welfare. They now bring up other services such as intraLATA toll in response. (p. A3) First, intraLATA toll is not a local competition issue but depends on pre-subscription issues which are not covered in this proceeding.²⁸ Moreover, even under DOJ's theory that intraLATA toll competition would somehow suffer from Section 271 relief, the

28. IntraLATA toll is merely a legal and regulatory artifice. Pre-subscription for intraLATA toll, not local competition, is the major economic issue.

intraLATA toll elasticity is only about 1/3 as large as the interLATA toll elasticity.²⁹ So once again changes in interLATA prices will have a significantly larger effect than changes in intraLATA prices.³⁰ The DOJ lawyers also bring up long distance access prices which are set by regulation. The FCC can fix this problem; to not let the BOCs compete because of FCC regulation seems a strange position. The last two categories, ISDN and vertical services, are extremely small compared to interLATA long distance, and thus could hardly offset consumer losses from decreased long distance competition. Overall, the DOJ lawyers miss the basic economic point--price decreases in interLATA long distance of the magnitude instituted by SNET in Connecticut lead to a greater increase in consumer welfare than any category (or the total of all categories) that the DOJ lawyers have mentioned.

45. The DOJ lawyers make essentially the same mistake as Prof Schwartz in their use of the industry price elasticity instead of the firm price elasticity (pp. A3-A4). Unless the BOCs form a cartel with AT&T, MCI, and Sprint, they will face a firm elasticity which exceeds 1.0 in magnitude. Neither Prof. Schwartz nor the DOJ lawyers have any basis to assume cartel like behavior if the BOC are permitted to enter the long distance market. Indeed, the behavior of SNET demonstrates the contrary outcome.

29. In testimony before the CPUC in 1992, I estimated the intraLATA toll elasticity to be -0.28, about 33% as large as the -0.73 elasticity for interLATA toll. This estimate has been confirmed by recent experience in California where the Office of Ratepayers Advocate has now adopted this elasticity in recently filed testimony.

30. IntraLATA toll competition would be increased by Section 271 relief because Section 271 (e) (2) requires dialing parity when Section 271 relief is granted. Thus, any potential increase in intraLATA toll competition would favor interLATA long distance relief for the BOCs.

46. The DOJ mischaracterizes my position on local competition. (p. A4) I favor local competition, and I favor long distance competition. As I have emphasized, the correct analysis considers whether the "regulatory perfection" standard of the DOJ which might cause a marginal increase in local competition, advances net consumer welfare compared to letting the BOCs compete in long distance once they satisfy Section 271 of the Telecommunications Act. Letting the BOCs provide long distance will not stop local competition; experience in both Canada and the U.K. has demonstrated otherwise.

47. The DOJ lawyers' criticism (p. A5) of my calculation of consumer benefits is wrong. My use of equation (1) provides the appropriate basis to calculate changes in consumer welfare; no economist, including Prof. Schwartz, has disagreed with its use. The DOJ lawyers attempt to diminish my estimate of a \$6-7 billion per year benefit to consumers by saying that a "a large share of the benefits...reflects transfers to consumers derived from reductions in price." Consumers benefit from reduced prices and the antitrust laws are designed to help consumers not long distance companies who these "transfers to consumers" will come from. AT&T, MCI and Sprint should compete for their profits, not have the DOJ attempt to protect these profits from "transfers to consumers" which the DOJ lawyers don't want to occur.

48. Imputation only affects the possibility of a "price squeeze", so the DOJ is incorrect about the effect of imputation on the ability of the BOCs

to lower long distance prices. (p. A5)³¹ Imputation rules set a price floor of long run incremental cost plus contribution for the price of a service. In the case of interLATA toll the price floor would be at most about 7 cents per minute. Thus, the BOCs would not be allowed to price below 7 cents per minute under section 272 (e) (3) of the 1996 act. I do not expect the BOCs to price this low. I expect them to decrease price by about 17% from current levels. Thus, BOC behavior will not be constrained by the imputation rules of the 1996 Act.³²

49. Both Prof Schwartz and the DOJ lawyers (p. A6) state that much of the BOC long distance revenues after entry will come from IXCs. SNET has decreased prices significantly in Connecticut, as AT&T itself recognized in a filing asking the FCC to allow AT&T to lower its rates for that state alone in October 1996. The BOCs have the economic incentive to decrease long distance prices, and they will be required to do so by consumers if BOCs want to succeed. AT&T has the best recognized corporate name in the U.S. as numerous surveys have shown and as AT&T repeatedly tells investment analysts. The BOCs cannot succeed unless they offer lower prices, just as happened in cellular long distance after the 1996 Act permitted the BOCs to provide cellular long

31. The DOJ lawyers error is addressed by the literature on imputation, including J. Hausman and T. Tardiff, "Efficient Local Exchange Competition", Antitrust Bulletin, 1995.

32. I am in favor of allowing long distance carriers as well as the BOCs to integrate vertically into local markets. (DOJ, A-6). Indeed, I have repeatedly pointed out that every country has permitted vertical integration, except the U.S. The DOJ lawyers should not attempt to misstate my position and attempt to protect competitors, or once again the result will be a perversion of the Sherman Act as a federal court opinion recently held, U.S. v. Kodak, 853 F.Supp. 1454, 1478 (W.D. New York 1994), affd., 63 F.3d, 95 (2d Cir. 1995).

distance. For the DOJ to assume otherwise is to ignore market experience of SNET in Connecticut and cellular long distance.

50. The DOJ is incorrect in its claim (pp. A6-A7) that I did not take into account differences in calling volumes in my price comparisons. Indeed, I recommend that the DOJ look at actual data rather than speculating about the "best rates" as they do on p. A-10. Customers buy actual long distance services, not the "best rates" which the DOJ attempts to use to rebut the clear implication from the data that long distance prices in Canada are now lower than long distance prices in the U.S.³³

51. The DOJ claims that the Commission should not permit the BOCs (and IXCs that want to use resold services) to bundle their services until some later date when the DOJ "regulatory perfection" standard is met (p. A7), again demonstrates the DOJ inability to understand that consumers would benefit now from bundling and increased competition in long distance. The DOJ makes no quantification of how much (if at all) consumers will be made better off by the Commission waiting until the DOJ regulatory perfection standard is met, as opposed to requiring satisfaction of Congress' competitive checklist. Meanwhile, consumers are losing \$6-7 billion per year in lost consumer welfare.

33. The DOJ lawyers attempt to confuse the issue by using an average long distance rate that includes both business and residential switched long distance rates. (p. A10, fn. 24) It is well known that businesses pay significantly lower prices for switched long distance service than do residential customers. Again, the DOJ could actually collect residential long distance data, but they did not do so. Note that the quoted figure here is significantly below the average rate for residential long distance of about 14 cents per minute which is widely cited in analysts reports and other public sources.

52. The DOJ cannot disagree that local competition in the U.K. is far more advanced than in the U.S. since 7% of residential U.K. subscribers use a CLEC. (pp. A7-A8). The DOJ correctly states that cable provides the main competition in the U.K. Over 96% of residences in the U.S. are passed by cable, yet cable has to date provided no competition to ILECs for residential exchange access service, although they have begun to provide competition for internet access service. The U.K. has allowed BT to compete and prices of both local service and long distance service have decreased. My point is that competition works better than artificially created regulatory barriers to entry which the DOJ wants to continue to impose on the BOCs. Every other country has chosen the competition path, not the barrier to entry path. The Telecommunications Act of 1996 also pointed the way to increased competition. The DOJ wants to continue the discredited "quarantine" policy of the MFJ, which has been adopted by no other country. More local competition exists in the U.K., lower long distance prices exist in Canada. Yet, the DOJ has become the leader of the IXC protection group by attempting to continue the barriers to BOC entry. I found it troubling that in its quest for "regulatory perfection", the DOJ is recommending anti-competitive policies which harm consumers.

53. DOJ support of the FCC's regulatory perfection policy is costing U.S. consumers about \$6-7 billion per year. The FCC and DOJ are not doing the correct marginal analysis which would compare this \$7 billion gain to the gain from the remaining barriers that they have identified. Thus, the economic analysis of the DOJ and Prof. Schwartz is incorrect. To the extent that Prof. Schwartz has done no quantification of these potential gains and losses and

has no economic model, no reliable conclusions can be drawn from his affidavit. Where is the increased competition that the Telecom Act of 1996 promised consumers? Prof. Schwartz and the DOJ ask consumers to wait a while longer. Yet the \$7 billion per year in lost benefits is now equal to 1/3 of the entire federal budget deficit. Where has the public interest standard gone? Consumer benefits, as opposed to protecting IXC competitors, seems to have been lost in Prof. Schwartz analysis and the DOJ lawyers rebuttal. U.S. consumers are paying a high price for the DOJ goal of "regulatory perfection" while the goal of the Telecommunications Act of 1996 goes unmet and consumers pay higher prices because of the DOJ-sponsored regulatory barrier to entry.

J. A. Hausman 18 Dec 1997

Jerry A. Hausman